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No. 89-1448

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1989

VIRGINIA BANKSHARES, INC., et al.,
Petitioners,

v.

DORIS I. SANDBERG, et al.,
Respondents.

FIRST AMERICAN BANKSHARES, INC., et al.,
Petitioners,

v.

PAUL H. WEINSTEIN, et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

~~MOTION FOR LEAVE TO FILE BRIEF AND~~ BRIEF OF THE NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Pursuant to Rule 37.3 of the Rules of this Court, the National Association of Securities and Commercial Law Attorneys ("NASCAT") respectfully moves for leave to file the enclosed brief as amicus curiae in support of respondents. Counsel for respondents has granted consent to file this brief. Counsel for petitioners also has granted consent to file this brief.

NASCAT is an association of law firms consisting of approximately 500 attorneys located throughout the United States whose purpose is to promote the enactment and enforcement of legislation which protects investors from deceptive and manipulative practices and ensures that the securities markets in the United States can operate in a fair and free manner. NASCAT members

have represented plaintiffs in a variety of individual and class action contexts under the federal securities laws; some NASCAT members have also represented defendants in securities and other cases.

NASCAT and its members have a strong interest in the effective private enforcement of the federal securities laws and in the development of case law that effectively deters would-be wrongdoers from perpetrating securities fraud upon public investors. Especially in light of increased level of merger activity, leveraged buy-outs, and other forms of corporate reorganization in recent years, the issues raised by this appeal are extremely important to the investment community and the capital markets generally.

The enclosed amicus curiae brief addresses the viability of a claim under Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C § 78n(a), for damages resulting from a materially misleading proxy solicitation in a "freeze-out" situation, i.e., where management owns sufficient shares to consummate the proposed transaction without approval of the minority shareholders. More specifically, the brief addresses the question whether minority shareholders in such a situation can prove that a deceptive proxy solicitation caused them damage.

Respectfully submitted,

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BRIEF OF THE NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF THE AMICUS CURIAE

As explained in the foregoing motion for leave to participate as amicus curiae, NASCAT is a national association of law firms consisting of approximately 500 attorneys located throughout the United States whose purpose is to facilitate protection of investors

and other consumers through appropriate legislative and judicial activity.

One of the issues in this case, i.e., the extent to which minority shareholders can pursue claims under Section 14(a) of the Securities Exchange Act of 1934 in a "freeze-out" situation, is extremely important. Largely as a result of innovative financing techniques and sheer economic growth, the level of mergers, leveraged buy-outs and other corporate restructurings have increased dramatically. As such, the issues presented in this case are extremely important to the investment community and the capital markets generally.

SUMMARY OF THE ARGUMENT

In situations where minority shareholders lack sufficient votes to prevent a proposed corporate transaction, minority shareholders can establish causation for purposes of a claim under Section 14(a). Moreover, causation may be established by proof that the proxy solicitation was materially misleading and was an "essential link" in the transaction.*

ARGUMENT

I.

MINORITY SHAREHOLDERS MAY RECOVER FOR VIOLATIONS OF SECTION 14(a) EVEN WHEN THEY LACK SUFFICIENT VOTING STRENGTH TO BLOCK THE TRANSACTION TO WHICH THE DEFECTIVE PROXY SOLICITATION RELATES

In *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), this Court reserved the question whether causation in a private action under Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), can be demonstrated when management controls a sufficient number of shares to approve the transaction as to which proxies are solicited without any votes from the minority.

* NASCAT does not address the issue concerning the actionability of representations about the reasons or purposes for corporate transactions.

Id. at 385 n.7. Since that decision, several courts, as well as scholarly commentators, have concluded that defendants can be held responsible for deceptive proxy solicitations even when the minority voting strength is insufficient to block the transaction. *See, e.g., Cole v. Schenley Industries, Inc.*, 563 F.2d 35, 39-40 (2nd Cir. 1977); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 383-384 (2nd Cir. 1974), *cert. denied*, 421 U.S. 976 (1975); *Valente v. Pepsico*, 454 F.Supp. 1228, 1248-49 (D. Del. 1978). *See also* Note, *Causation and Liability in Private Actions for Proxy Violations*, 80 Yale L.J. 107 (1970). NASCAT respectfully submits that this view is correct.[1]

The Securities and Exchange Commission ("SEC") and the Federal Deposit Insurance Corporation ("FDIC"), as amici curiae, persuasively argue that a deceptive proxy solicitation may cause injury to minority shareholders in several ways. First, the shareholders may be induced to vote in favor of a transaction, thereby precluding appraisal remedies. *See* Brief for the Securities and Exchange Commission and the Federal Deposit Insurance Corporation as Amici Curiae ("SEC Brief") at 24-25.[2] Second, a minority shareholder may refrain from pursuing injunctive relief or may fail to obtain such relief, even if he pursues it. *Id.* at 25. Third, the proponents of the transaction may be unwilling to proceed with the proposed transaction if truthful disclosure were required, such as in situations where the exercise of appraisal remedies by all minority shareholders would be deemed prohibitive by management. *Id.* at 26.[3] *See also Schlick v. Penn-Dixie*

[1] In addressing these issues, NASCAT does not concede that petitioners have preserved their claims for review by this Court.

[2] A misleading proxy solicitation may dissuade a minority shareholder from pursuing appraisal rights even where the minority shareholder does not vote on the transaction or where he votes against it. Regardless of how the minority shareholder votes—or whether he votes at all—the deceptive proxy solicitation may discourage him from pursuing appraisal rights.

[3] Indeed, it is possible to conceive of a situation where, regardless of the proponents' subjective state of mind, the assets of the corporation may be insufficient to satisfy appraisal rights pursued by the minority

Cement Corp., 507 F.2d at 384 (proponents of transaction may be dissuaded from pursuing transaction if proxy solicitation would entail public disclosure of unfavorable information). Such examples clearly demonstrate that minority shareholders must be permitted to seek redress under Section 14(a) even in situations where management owns sufficient shares to consummate the proposed transaction.

Recognition of the right to redress in such situations is fully consistent with policies underlying the federal securities laws. That the Securities Exchange Act of 1934 was designed to implement a policy of "full disclosure" has been repeatedly recognized by this Court. *E.g., Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988). Moreover, the Court has consistently held that the federal securities laws should be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-387 (1983) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Yet if this Court were to preclude claims under Section 14(a) by minority shareholders—regardless of how outrageous the fraud—it "would 'sanction all manner of fraud and overreaching. . .'." *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d at 383 (quoting *Swanson v. American Consumer Industries, Inc.*, 415 F.2d 1326, 1331 (7th Cir. 1969). This cannot be.

Recognition of the ability of minority shareholders to prove causation in a "freeze-out" situation—thereby enabling them to bring claims under Section 14(a)—will not only protect minority shareholders; it will also promote the integrity of the trading markets. Because publicly-disseminated information is absorbed in securities prices (*see Basic Inc. v. Levinson*, 485 U.S. at 246-247), the effects of a misleading proxy solicitation are not confined to the pre-existing shareholders of the corporation, but also affect those who trade—or even consider trading—the corporation's securities. As the Second Circuit has recognized, "[b]y disclosure the *market* will be informed, so as to permit well-based

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shareholders *en masse*. *See Cole v. Schenley Industries, Inc.*, 563 F.2d at 39-40. *See also* Note, *supra*, 80 Yale L.J. at 127-128.

decisions about buying, selling and holding the securities involved in the transaction. [citation]." *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d at 384 (emphasis in original).

In sum, acceptance of petitioners' argument would encourage the precise sort of fraud that the Securities Exchange Act was designed to prohibit. Especially at a time when public confidence in the capital markets and financial institutions has been severely tested by public revelations of insider trading, the downfall of venerable Wall Street firms and the collapse of the savings and loan industry, it is important that this Court insist on truthfulness by those in positions of corporate responsibility.[4]

II.

"CAUSATION" MAY BE ESTABLISHED BY PROOF THAT THERE WAS A MATERIAL MISREPRESENTATION AND/OR OMISSION AND THAT THE PROXY SOLICITATION WAS AN ESSENTIAL LINK IN THE TRANSACTION

NASCAT submits that causation may be established in a "freeze-out" situation upon proof that the proxy solicitation contained a material misrepresentation and/or omission and was an essential link in the transaction. Furthermore, NASCAT submits that the approach urged by petitioners, i.e., that plaintiffs must prove that they would have succeeded in preventing the transaction if they had been advised of the truth, is erroneous.

In *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), this Court stated:

> Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between

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[4] The fact that, in some cases, minority shareholders might have statutory appraisal rights does not vitiate the need to recognize claims by minority shareholders under Section 14(a). Appraisal remedies are cumbersome (*e.g.*, Eisenberg, *Modern Corporate Decisionmaking*, 57 Cal. L. Rev. 1, 85 (1969)) and may not permit redress on a class-wide basis. Thus, the possibility of appraisal remedies will not itself provide an effective deterrent to fraud.

> the violation and the injury for which he seeks redress if, as here, he proves the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction.

Id. at 385.

Any suggestion that the "essential link" concept cannot apply in a "freeze-out" situation is false; indeed, a materially misleading proxy solicitation may be necessary in a variety of ways. In a "freeze-out" situation, the materially misleading proxy solicitation may be an "essential link" in that, *inter alia*, it (1) conceals a material fraud which, if disclosed, would result in an injunction against the proposed transaction, (2) dissuades or precludes shareholders from pursuing appraisal rights, (3) enables management to avoid adverse publicity which might effectively preclude the transaction, or (4) is necessary for legal or practical reasons. *See generally* Note, *supra*, 80 Yale L.J. at 123.

Indeed, it is entirely reasonable to suppose that a majority shareholder would not disseminate a materially misleading proxy solicitation unless he perceives that full and fair disclosure would cause results which are disadvantageous or prohibitive. In a situation where he controls enough votes to approve the transaction—and therefore does not need to induce persons to vote in favor of it—what other reason does he have to lie?

Although petitioners assert that a minority shareholder must prove that he would have prevented the transaction had the true facts been disclosed (Brief for Petitioners at 47), this is erroneous. First, petitioners' approach requires proof which is essentially hypothetical. Second, petitioners' approach may deprive minority shareholders of the right to recover, even though they may have been directly injured as a result of the misleading proxy solicitation. Third, petitioners' approach serves no valid purpose in a "freeze-out" situation. Thus, petitioners' approach should be rejected.

This Court has previously rejected the requirement that plaintiffs prove matters which are hypothetical. For example, in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), the Court refused to require plaintiff in an ordinary voting situation to show how the

voting would have been different had the truth been told. *Id.* at 384-385. Also, in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Court declined to require that open market purchasers of securities prove how they would have acted had the truth been told. *Id.* at 230. There, the Court stated,

> Requiring a plaintiff to show a speculative state of facts, i.e., how he would have acted if omitted material information had been disclosed . . . or if the misrepresentation had not been made . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market.

Id. (citations omitted).

Here, petitioners seek to impose the same type of burden, i.e., proving a hypothetical, on minority shareholders. However, there is no reason to do so.

In addition, petitioners disregard the fact that minority shareholders may be injured as a direct consequence of the alleged fraud, even if they cannot actually stop the transaction. For example, in some situations minority shareholders will have appraisal rights; a shareholder who is fraudulently induced to forego appraisal rights by virtue of a misleading proxy solicitation is clearly injured as a direct consequence of defendants' wrongdoing, even if he cannot prove that he would have been able to actually stop the transaction. *See* Note, *supra*, 80 Yale L.J. at 128-129. It is therefore unnecessary to require proof that the transaction would have been stopped.

Finally, the test suggested by petitioners improperly permits the possibility that a claim under Section 14(a) will be denied for reasons wholly unrelated to the merits of plaintiffs' allegations. For example, a plaintiff may be required to post a bond in order to obtain injunctive relief; under petitioners' theory, evidence that an aggrieved shareholder would not be able to post a bond presumably would preclude proof of causation, even though such a result is clearly anomalous. Similarly, if defendants can show that injunctive relief would have been denied by the state court solely because of the perceived availability of adequate legal remedies—regardless of the strength of plaintiff's claims on the merits—that

would presumably preclude a claim for damages under petitioners' view of causation. This, too, is illogical.

In sum, petitioners' theory of causation seeks to encumber important claims under Section 14(a) with inappropriate burdens of proof. Their attempt to subvert Section 14(a) claims by erecting such inordinate burdens must be rejected.

CONCLUSION

The decision of the Court of Appeals should be affirmed.

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